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TERESA OLCOTT COHEA
LEGISLATIVE FISCAL ANALYST

November 1, 1991

TO: Legislative Finance Committee

FROM: Jim Standaert
Associate Fiscal Analyst JES

RE: Update on School Bonding Issues

BACKGROUND

In 1988, the first district court in the "Loble" decision declared Montana's method of funding K-12 education--including the financing of capital outlay--unconstitutional. In February 1989, the Montana Supreme Court upheld this decision as it applied to the foundation program. However, it is unclear whether the Supreme Court decision also applied to capital outlay funding. Due to the passage of House Bill 28 in the June 1989 special session and in anticipation of the passage of further legislation in 1991, the Supreme Court waived jurisdiction over the school funding case in fiscal 1990. At the same time, the Court declared in a January 4, 1990 supplement to its opinion that the 1989 decision did not affect the validity of any bonds issued prior to July 1, 1991. This enabled schools to continue selling bonds for capital outlay projects backed by the current funding mechanism until after the 1991 legislature.

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In May 1991, a representative of Dorsey and Whitney, a major bond counsel firm, stated that the firm could not give an unqualified opinion on school bond issues sold under current statutes after June 30, 1991 (the expiration date of the court's supplementary ruling) without a declaratory judgement by the Montana Supreme Court that the bonds were valid under current statutes. Since bond counsel's opinion that bonds represent a valid obligation of a school district is a key factor in bond sales, lack of an unqualified opinion effectively eliminates financing for most major school district projects.

On June 28, 1991, the state filed a petition asking that the Montana Supreme Court "enter a second supplemental order providing that the February 1989 opinion shall not affect the validity of school bonds prior to the date of a subsequent judicial determination that the existing methods of financing the debt service and building reserve funds is unconstitutional." On October 7, the Supreme Court denied this petition, stating:

> "a further postponement of our determination of unconstitutionality is not the proper means to correct the funding problem....Such requests in connection with the funding system should be directed to the legislative and executive branches of government."

In a meeting of the Revenue Oversight Committee on October 4th, 1991, Dorsey & Whitney bond counsel said that under certain conditions they may render a <u>qualified</u> opinion regarding the validity and enforceability of local school bonds. The conditions under which such an opinion could be rendered includes action by the Board of Investments to purchase school bond debt.

At the same meeting, the executive director of the Board of Investments indicated that Board staff are researching the possibility of investing coal tax

trust funds to purchase school bonds. He indicated that such purchases would be subject to the same credit reviews as other investments and that the interest rate required would need to be at the market rate for similarly risky investments. The resulting interest rate would be substantially above the current rate on tax-exempt school bonds since the Board has no need for tax-sheltered income. The executive director noted these investments would probably be short term, allowing school districts to refinance the debt with long-term tax-exempt bonds in the event the 1993 legislature devised a system of capital outlay funding which addressed the constitutional issue.

At its October 25 meeting, the Board of Investments discussed issues relating to its role in financing the purchase of school bonds. Board staff outlined the general risks and potential returns of such investments. The risks include the possibility that the legislature may take an action that makes it legally impossible for a school district to fully repay its debt to the Board[1]; or a taxpayer convinces a court to enjoin (and thereby delay) the district from collecting property taxes dedicated to paying debt service to the Board until the legislature has resolved the issue.

Board staff said that various funding options are still being explored: 1) investment of coal tax trust funds in "callable" bonds or notes from school districts, possibly in amounts small enough to meet construction costs as they arise; and 2) pooling school district bonds into one or more bond issues which

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For instance, placing a ceiling on the amount of funds that may be spent for construction of a district building. If the Board has committed an amount in excess of the ceiling, it may be impossible for the district to repay the Board.

would be sold under the Municipal Finance Consolidation Act. The second option may enable school districts to receive funding at a lower tax exempt interest rate.

No schools have issued bonds since July 1, 1991. Some school districts have passed bond elections (Clancy, Monforton, Bonner). Others have indicated that they anticipate elections will be held in the near future (Plentywood, Lone Rock, Livingston, Frenchtown, Kalispell, West Glacier, Havre, Missoula). The Superintendent of Public Instruction's office is preparing a priority list of school districts in greatest need of facility financing for the Board.

The Board of Investments anticipates taking action on staff recommendations at its December 13 meeting.

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BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE

STAN STEPHENS, GOVERNOR

CAPITOL STATION

STATE OF MONTANA

(406) 442-1970 TELEFAX (406) 449-6579 HELENA, MONTANA 59620

November 4, 1991

Mrs. Teresa Cohea
Legislative Fiscal Analyst
State Capitol
Helena, Montana

Dear Mrs. Cohea:

I would like to give you the benefit of our most recent plans concerning the school bond problem.

The Board directed staff to prepare a recommendation to be presented to the December 13 meeting. At the current time our research has led us to the conclusion that we can probably put together a short term bond issue which could be rated and sold to the investor community. We would use the proceeds of that bond issue to purchase voter approved debt instruments, at tax exempt rates, from the various qualifying school districts.

The intent would be to sell short term bonds which would be retired when the legislative equalization issue is resolved and districts are able to reissue their own long term bonds.

We still have some work to do on this and will have a final report by December 13, 1991.

Sincerely,

David M Lewis

David M. Lewis
Executive Director

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